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National Housing Act of 1954, as amended.

The Department of Housing and Urban Development's (HUD) accounting systems for mortgage insurance premiums and for property tax liabilities have resulted in many problems. Findings/Conclusions: In May 1976 and December 1976, GAO reported to the Secretary of HUD on the need for the Department to collect delinquent mortgage insurance premiums due from mortgages, improve its collection procedures, and improve its accounting system and supporting automatic data processing system. HUD sends about 25,000 premium billings in error each month because the Offices of Finance and Accounting and ADP Operations do not use established internal controls to assure all mortgage transactions sent in by mortgages are completely and accurately entered in the master billing file. HUD annually loses about \$14.6 million in interest due to insurance premium collection policies. There are opportunities for substantial savings in HUD's Section 222 mortgage insurance premium payment system. Improvements are still needed in HUD's accounting system for paying property taxes. Recommendations: HUD should: follow the 15-day criteria of the mortgage banking industry for identifying delinquent accounts; assess late payment charges; and use its suspension authority in flagrant cases. The Secretary of HUD should amend HUD regulations to require mortgages to pay insurance premiums monthly as they are collected from mortgagors. The Secretaries of HUD and Defense should evaluate the need for the Government to continue to pay housing insurance premiums for military personnel. (SC)

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STATEMENT OF
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MANAGEMENT STUDIES DIVISION
BEFORE THE
SUBCOMMITTEE ON MANPOWER AND HOUSING
COMMITTEE ON GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES

ON

HUD'S ACCOUNTING SYSTEMS FOR
MORTGAGE INSURANCE PREMIUMS AND
PROPERTY TAX LIABILITIES

Madam Chairwoman and Members of the Subcommittee:

We are here today at your request to discuss two reviews of the Department of Housing and Urban Development's (HUD) accounting systems for mortgage insurance premiums. We will also discuss our followup review of HUD's accounting system for paying property taxes on acquired single family residential property. With me today are Mr. John Cronin, Assistant Director of our Financial and General Management Studies Division, and representatives of our Cincinnati Regional Office who participated in the review.

HUD ACCOUNTING SYSTEM FOR BILLING
AND COLLECTING MORTGAGE INSURANCE PREMIUMS

First I would like to discuss our review of HUD's accounting system for billing and collecting mortgage insurance premiums.

The National Housing Act of 1934 (12 U.S.C. 1709) established a mortgage insurance program. Under this program, lending institutions such as a bank, insurance company, building and loan association, or mortgage company, finance mortgages and the Department of Housing and Urban Development (HUD) insures them to protect the lender, or mortgagee, against defaults. HUD insured mortgages for 4.9 million single-family residences as of December 31, 1976, and collected over \$300 million in insurance premiums in calendar year 1976.

Homeowners or mortgagors include one-twelfth of their annual mortgage insurance premium in the monthly payment made to the mortgagee. The mortgagee deposits the insurance premium in a separate non-interest bearing account (escrow account) until HUD bills for the amount due on the annual anniversary month of the insurance contract.

Each month HUD sends about 400,000 bills to mortgagees for insurance premiums collected from mortgagors during

the preceding 12 months.

HUD's procedures provide for delinquent notices to be sent to mortgagees every 20 days for premiums which have not been paid. If a mortgagee does not pay the delinquent premiums, or furnish adequate evidence to substantiate the reasons for not paying them, HUD can either collect the delinquent premiums through legal action or suspend the mortgagee's license to further finance insured properties.

When HUD's overall accounting system was approved by our office in 1970, the operational mortgage insurance accounting system was one of the subsystems that was not documented or submitted for approval. The subsystem was, however, expected to be documented to conform to the principles and standards of the overall system.

In May 1976 and December 1976, we reported to the Secretary of HUD on the need for the Department to collect delinquent mortgage insurance premiums due from mortgagees, improve its collection procedures, and improve its accounting system and supporting automatic data processing (ADP) system. However, much remains to be done.

MILLIONS OF DOLLARS IN DELINQUENT
MORTGAGE INSURANCE PREMIUMS NOT COLLECTED

Each month since January 1976, reports generated by HUD's accounting system have shown about \$18 million in delinquent premiums outstanding from mortgagees. HUD's system identifies premiums as delinquent when they are 50 days past due. The mortgage banking industry, however, identifies premiums as delinquent when they are 15 days past due. If HUD used the mortgage banking industry criteria, we estimate that the delinquent premiums each month would amount to about \$38 million.

HUD's procedures require it to bill mortgagees 30 days before the premiums are due. Some mortgage companies, however, do not promptly pay these bills even though they have collected the premiums from mortgagors over the preceding 12 months and placed them in escrow accounts. HUD allows mortgagees to continuously pay late because it does not (1) promptly identify and notify mortgagees of their delinquencies, (2) take effective collection action, (3) assess late payment charges, and (4) suspend mortgagees who abuse their privilege to finance HUD-insured properties. Because many mortgagees pay premiums late, HUD is denied use of these funds to pay mortgage defaults

and is required to obtain needed funds through appropriations and borrowing. This tends to increase Governmental interest costs.

If HUD had adopted the banking criteria of granting 15 days for payment and had collected the \$38 million we estimate was delinquent during the entire calendar year 1976, Government interest costs might have been reduced by as much as \$2.5 million.

NEED TO PROMPTLY IDENTIFY
DELINQUENT PREMIUMS AND TAKE
EFFECTIVE COLLECTION ACTION

HUD does not identify delinquent accounts and notify mortgagees of the delinquencies within 20 days as required by its regulations. In fact, HUD does not identify accounts as delinquent until at least 50 days after the due date because, HUD personnel said, "We do not have time." Even after delinquent premiums are identified, HUD does not notify all mortgagees of the delinquencies. For example, we selected 127 mortgagees who paid premiums late in either March, April, or July 1976, and found that HUD sent delinquent notices to only 41 of the 127 delinquent mortgagees. The delinquent notices were sent an average of 72 days after the premium due date. We could not tell if notices were sent to 14 of the mortgagees. In the

remaining 72 cases, HUD personnel again said, "We did not have time" to send delinquent notices. They said if they changed from a 50-day to a 20-day cycle, the time problem would be even worse.

Although the 127 mortgagees eventually paid the premiums, they paid them up to 274 days late.

We believe HUD's collection practices have the effect of encouraging mortgagees to pay late because most mortgagees know they will not be identified as delinquent until at least 50 days after their premiums are due. Our analysis during one period showed that 540,000 premiums were delinquent after 15 days, but this number was reduced to 257,000 after 30 days. We believe HUD further encourages late payment practices among mortgagees by not sending delinquent notices to them as required by HUD's regulations.

We believe that HUD should follow the 15-day criteria of the mortgage banking industry for identifying delinquent accounts. By doing this, we believe HUD would stop the late payment practices of many mortgagees. HUD should also assess late payment charges, and use its suspension authority in flagrant cases. I will briefly discuss these enforcement tools.

HUD regulations should be amended to provide for late payment charges

HUD does not assess mortgagees a late payment charge for delinquent premium payments even though mortgagors are normally required to pay premiums to mortgagees within 15 days after the due date or are assessed a penalty for late payments. In addition, several other Federal agencies, such as the Energy Research and Development Administration, General Services Administration, Veterans Administration, Internal Revenue Service and Department of the Interior do charge interest for late payments. The Energy Research and Development Administration, for example, charges 12 percent per annum from the due date to date of payment on delinquent accounts and collected over \$832,000 in late payment charges in fiscal year 1976. If HUD assessed mortgagees a late payment charge, it would provide an incentive for mortgagees to pay on time.

Authority to suspend mortgagees not used

According to its regulations, HUD can suspend mortgagees for criminal, fraudulent, or improper conduct. A suspension precludes mortgagees from financing additional mortgages during the suspension period. We analyzed records in HUD's Office of the General Counsel to see if

HUD had suspended mortgagees who were not paying premiums on time. There were no suspension notices on file in HUD's records and, according to its General Counsel, no mortgagee has ever been suspended for not paying premiums or for paying premiums late. Although this authority is not used by HUD, we think it is an appropriate recourse against mortgagees that persistently abuse their privilege of obtaining HUD insured mortgages.

An example where late payment charges or suspension could have been used

During our review we identified one mortgagee that had not paid mortgage insurance premiums for over 10 months and owed \$1.6 million for these premiums. We believe HUD should have considered late payment charges or suspension in this case.

At our request, a HUD employee telephoned the mortgagee and asked that the delinquent premiums be paid. Although the mortgagee promised prompt payment, 10 days elapsed and no payment was received. Additional telephone inquiries led to similar promises, but again, no payments were received.

After 30 days had elapsed we asked HUD to notify the mortgagee that our representatives would visit the firm for an audit. Two days later, a vice president of the mortgage company came to HUD Headquarters and paid \$1.1 million in delinquent premiums. An additional \$500,000 was mailed to HUD during our audit at the firm. When asked why the bills were not paid when due, the mortgagee said the monthly insurance premium checks had been prepared but not mailed because other administrative matters were given higher priority.

In an interim report to the Secretary of HUD dated May 4, 1976, we recommended that HUD review the circumstances in this case to determine if any further action regarding the firm was warranted. Because we noted many other mortgagees who were persistently delinquent, we also recommended that HUD collect the millions of dollars in delinquent premiums and consider an interest penalty for late payments. The former Chairman of this Subcommittee requested the Secretary of HUD to provide a response to the findings and recommendations in our interim report.

The Secretary's reply to the Subcommittee Chairman stated that HUD had thoroughly reviewed the delinquent mortgagee and took no punitive action because the firm agreed to pay its future premiums on time. Further, the Secretary stated that HUD was sending delinquent premium notices to mortgagees on all past due premium accounts. However, our sample of delinquent accounts as of July 1976 showed that 42 mortgagees paid premiums up to 98 days late, but HUD sent delinquent premium notices to only 8 of them.

The Secretary also stated that HUD was considering an amendment to its regulation which would provide for an interest charge on premiums not paid within a reasonable time. HUD's General Counsel said it may be improper to assess a late payment charge on premiums currently delinquent, but after notifying mortgagees, late payment charges could be assessed on future premiums that become delinquent. HUD plans to amend its regulations to permit such a charge.

AUTOMATED SYSTEM OF ACCOUNTING
AND BILLING NEEDS IMPROVEMENT

HUD sends about 25,000 premium billings in error each month because the Offices of Finance and Accounting (Accounting) and ADP Operations do not use established internal

controls to assure all mortgage transactions sent in by mortgagees are completely and accurately entered in the master billing file. Many of these billing errors prevent HUD from collecting the premiums when they are due. Both HUD and the mortgagees must spend a lot of time and money to correct the errors.

The errors are caused primarily by weaknesses in maintaining the master billing file and in operating HUD's accounting system, such as (1) poor document control resulting from the failure of accounting clerks to follow established procedures, (2) failure to submit all source document data into the computerized system and failure to reenter data initially rejected by the system, (3) failure to correct errors reported by mortgagees, and (4) inadequate control and coordination in processing transactions between the Office of Finance and Accounting and the Office of ADP Operations. At the conclusion of my statement, Mr. Cronin will illustrate how the system works and where the problems are occurring.

POTENTIAL SAVINGS OF \$14.6 MILLION
BY CHANGING MORTGAGEE PAYMENT METHODS

HUD annually loses about \$14.6 million in interest because mortgagees are permitted to collect insurance

premiums from mortgagors and retain them up to 12 months before HUD bills the mortgagees for the premiums. This denies HUD the use of these funds for investments when excess funds are available and requires it to borrow from the U.S. Treasury to meet mortgage defaults when funds are not available. For example, on May 31, 1976, HUD borrowed \$168 million from the U.S. Treasury for its General Insurance Fund from which default payments are made. Interest on borrowings at September 30, 1976, was 8 percent.

To collect insurance premiums sooner, HUD could require mortgagees to send a check for the amount of premiums collected each month from the mortgagors. Once a year HUD could bill a mortgagee as it is now done and bills could be reconciled to the payments that had already been made. While the interest income or savings in interest costs to HUD will be substantial, we do not believe the administrative expenses of HUD or the mortgagees would materially increase if funds were remitted to HUD monthly.

To correct the deficiencies that I have been discussing, we are suggesting the Secretary of HUD should:

--collect all delinquent mortgage insurance premiums,

- identify all mortgage insurance premiums that have not been received at HUD within 15 days after the due date and promptly notify all delinquent mortgagees,
- amend the HUD regulations to provide for late payment charges on premiums remitted more than 15 days past the due date,
- suspend mortgagees from further participation in HUD programs when they flagrantly abuse the insurance contract, and
- amend HUD regulations to require mortgagees to pay insurance premiums monthly as they are collected from mortgagors.

OPPORTUNITIES FOR SUBSTANTIAL SAVINGS
IN HUD'S SECTION 222 MORTGAGE
INSURANCE PREMIUM PAYMENT SYSTEM

I will now discuss our review of HUD's mortgage insurance program for military personnel.

Section 222 of the National Housing Act of 1954, as amended, established a mortgage insurance program for servicemen in the Armed Forces, Coast Guard, and National Oceanic and Atmospheric Administration. The program's purpose was to make it easier for servicemen to buy a home at a time when Veterans Administration guaranteed loans were unavailable and servicemen's pay was relatively low.

The mortgage loan is made by a HUD approved lending institution, but unlike other HUD mortgage insurance programs, the one-half percent premium is paid by the

agencies directly to HUD. The payments are an indirect subsidy to eligible servicemen amounting to an average of about \$85 per year.

The premium payment is due the first day of the month in which HUD endorsed the insurance. HUD sends annual bills to the agency each month for servicemen's premiums that are due the following month. As such, the payments are simply a transfer of funds between Federal agencies. In calendar year 1975, HUD billed the services for over 31,000 premiums.

HUD'S BILLING AND COLLECTION
SYSTEM CAN BE SIMPLIFIED

Our review disclosed that HUD's procedures to bill, reconcile, and collect servicemen's mortgage insurance premiums are cumbersome, ineffective, and costly. Frequent and numerous record changes must be processed by both HUD and the agencies if funds are to be transferred accurately and on time.

Furthermore, HUD is not keeping its master billing record current. For example, in 1975 HUD mailed about 31,000 premium notices to DOD, but DOD refused to pay about 7,000 of these bills.

We reviewed HUD's billing to DOD for 1 month consisting of about 2,500 bills. About 600 or over 20 percent of these bills were sent to the wrong party. HUD should have sent about 500 of the bills to a mortgage company since the military personnel had been terminated from the program. Approximately 100 bills were not paid because the DOD service branch had no record of eligibility, and many of these were sent to the wrong address because of incorrect data in the billing file. Further, about 200, or one-third of the 600 errors, were reported by DOD in 1974 but were not corrected by HUD.

In most cases HUD had been notified that a serviceman's eligibility had been terminated and the premium was collectible from the mortgagee. But HUD did not update its master billing file primarily because incorrect data rejected by the computer and printed out in exception lists was not revised and reentered into the system. The records were not corrected because HUD's Office of Finance and Accounting had not reviewed the automatic data processing exception listings since August 1972. When errors from one period are not corrected, the errors have an adverse effect on the billings during succeeding periods. By not correcting the reported errors, HUD caused the error rate to grow from 4 percent in 1972 to over 20 percent

in 1975. The supervisor in charge of the section responsible for processing changes reported from Defense stated that staffing limitations prevented the assignment of personnel to review the exception lists and reenter the data as required. We brought this matter to the attention of HUD officials, who stated they were unaware that the exceptions were not being corrected.

The salary cost to bill and reconcile these premiums alone is about \$700,000 a year - 36 HUD employees, four Army employees, five Air Force employees, one Marine Corps employee, one Coast Guard employee, and two Navy employees. These personnel costs represent an expense of about \$.20 for each \$1 collected by HUD.

One reason for the high administrative costs is the procedure used to update HUD's master billing file. The agencies must research their files and compare the premium notices against their active eligibility files. They pay premiums to HUD only for eligible servicemen. The agencies list and return the invalid premium notices to HUD on premium reconciliation forms which explain why the agencies are not paying the amounts billed.

When HUD receives the agencies' reconcilements it, in turn is supposed to research its records to see why the bills were invalid and prepare correcting records for the HUD master billing file. But, HUD has not effectively kept up with the necessary changes to its computerized master billing file.

When the billing files are not properly updated HUD sends bills to the wrong agency, does not bill at all, or bills the agency after the serviceman's eligibility terminates. In some instances the agency overlooks some invalid bills and pays them only to have HUD refund the money later. The net effect of not correcting billing errors is much papershuffling between agencies which leads to an administrative nightmare and increased cost to both HUD and the agencies involved--just to transfer funds between Federal agencies.

TO WHAT EXTENT SHOULD THE GOVERNMENT PAY
HOUSING INSURANCE PREMIUMS FOR MILITARY
PERSONNEL?

During our review of the billing and collection system, it came to our attention that circumstances had changed since the enactment of the legislation giving servicemen this benefit. When Congress authorized the Section 222

program in 1954, servicemen were on relatively low salaries and were ineligible for Veterans Administration home loans. The Congress felt the servicemen needed the Government to pay the insurance premiums so they could purchase homes. As many as 65,000 servicemen have used the Section 222 program but by 1976, participation had declined to about 24,000, a drop of about 62 percent.

Since 1954, servicemen have received several pay increases. To ascertain the ranks and compensation of those participating in the program, we sampled about 1,800 servicemen participating in the program. The average military compensation was about \$18,000 annually. This amount represents the sum of basic pay, quarters and subsistence allowances, and value of tax advantages.

Our sample of 486 field grade officers (Major or Lt. Commander) and above showed that those officers' military compensation ranged from \$23,258 to \$45,808 annually. Although the intent of this program was to financially aid military personnel in buying homes when salaries were low, we believe aid to military personnel is now questionable because salaries have significantly increased since inception of the program. For example, there were 8

Generals in our sample whose regular military compensation exceeded \$40,000. In addition, one officer in our sample, a Colonel whose regular military compensation exceeds \$35,000, is renting the home he purchased under the program and residing in Government housing in the same community. The regulations allow DOD to continue paying the Colonel's insurance premiums as long as the officer owns the home.

One reason for the declining participation is changed conditions. Servicemen are now eligible for Veterans Administration guaranteed home loans which feature:

- a moderate interest rate,
- low or no down payment,
- a long amortization or repayment period,
- assurance that the serviceman can pay all or part of the loan in advance without penalty, and
- an inspection and appraisal.

Since 1954 HUD has developed several other subsidized programs which eligible military personnel can use, such as the homeownership program under section 235 of the National Housing Act. The amount of the subsidy depends

on the borrower's income. If the purchaser cannot afford the entire mortgage payment with 20 percent of his income, HUD can limit his interest cost to as low as 5 percent. The program is designed to help families with an adjusted income of \$9,000 to \$12,000.

Also, HUD's Director of Mortgage Insurance Accounting has recognized since 1972 the need for changes in the program. On three occasions he proposed changes in the method of operating the program. The proposal pointed out the high administrative costs to transfer funds between agencies and suggested the program be abolished. HUD, however, has never acted on the proposal.

As a result of our findings, we are suggesting that the Secretaries of HUD and DOD should evaluate the need for the Government to continue to pay housing insurance premiums for military personnel in light of new programs available to these personnel and determine whether income eligibility criteria should be established considering their wide range of compensation.

In the meantime, we believe that the Secretary, HUD should have the following actions taken:

- Update the master insurance billing files for the changes rejected by the computer since 1972,
- Follow established procedures for researching and correcting automatic data processing exception listings, and
- Simplify the interagency transfer of funds by preparing a composite annual billing to DOD in lieu of an annual bill for each of 24,000 eligible military personnel in the program.

IMPROVEMENTS ARE STILL NEEDED IN HUD'S ACCOUNTING SYSTEM FOR PAYING PROPERTY TAXES

I will now briefly discuss our third review which is a followup on our previous review of HUD's system of accounting for property tax liability on acquired residential property.

The National Housing Act provides that any real property acquired and held by the Secretary of HUD is subject to taxation by any State or political subdivision thereof, on the same basis as other real property is taxed. In addition, HUD has assumed responsibility for paying taxes on those properties for which the Secretary of HUD holds the first mortgage. Each mortgagor is required to pay HUD monthly an amount sufficient to pay his taxes in addition to his mortgage payment. HUD in turn is supposed to pay the taxes when they are due.

Our prior review showed weaknesses in the procedures and practices followed by HUD in administering its property tax payment system and led us to the conclusion that HUD has

an inadequate system for controlling property tax payments on acquired single-family residences.

Our review showed that HUD:

- Needed to eliminate substantial errors in its tax records,
- Had paid taxes on property it had sold and no longer owned,
- Had not paid taxes that it does owe,
- Had made late payments and thereby incurred unnecessary penalty and interest costs,
- Had made duplicate tax payments on some properties, and
- Had not received credit from local tax authorities for delinquent taxes paid to property buyers at the time of sale.

In our report of November 26, 1975, entitled "Action Being Taken to Correct Weaknesses in the System of Paying Taxes on Acquired Residential Properties", we suggested that HUD could improve its system of accounting for property tax liability on acquired single family property by:

- investigating the feasibility of automatic data processing as used by the mortgage and banking industry.

--establishing an accurate property tax master file.

--promptly notifying local taxing authorities of acquisitions and sales.

--delegating responsibility for obtaining and verifying tax bills to local HUD offices.

Our findings and recommendations were the subject of my testimony before this Subcommittee on September 25, 1975.

HUD PILOT PROGRAM

To improve its system, HUD established a pilot program in the Cincinnati Insuring Office to test the effectiveness of decentralizing the tax payment function on acquired single-family property. The test ran from November 1975 to March 1976, during which the Cincinnati Insuring Office established and maintained tax data records, requested tax bills, validated tax bills received, and processed valid tax bills to the Chicago Regional Office for payment.

In order to evaluate HUD's success in decentralizing tax payments, we reviewed a semi-annual tax payment to Hamilton County, Ohio, which was due August 6, 1976. We reviewed local insuring office records; county court house ownership and tax records; area office records maintained in Columbus, Ohio; and Central Office records maintained in Washington, D.C., to establish the total number of acquired single family properties in Hamilton County.

Decentralization of the tax payment function to the local insuring office is a substantial improvement over the previous centralized system. However, the Cincinnati Insuring Office is still paying some taxes late while failing to pay other taxes, and is receiving some tax bills on property it no longer owns. Some of the problems which cause these situations are beyond the local office's control, while others are a result of weaknesses in the implementation of the pilot program in Cincinnati. We informed HUD of these weaknesses.

Although HUD has decentralized responsibility for paying taxes to the local HUD insuring offices on acquired single family properties, these properties represent only 8 percent of HUD's \$242,000 tax liability in Hamilton County and 27 percent of HUD's taxable properties in the County. HUD Headquarters continues to retain control over property taxes on multi-family and assigned single family properties. We have observed tax payment deficiencies on multi-family and assigned single family properties similar to those we reported to HUD in July 1975 on single-family properties. We noted instances where HUD had:

- paid taxes on property which had been sold and was no longer HUD's responsibility.

- not paid taxes on property it was responsible for.

--collected tax escrow payments from mortgagors and then failed to pay their taxes.

--made late payments and thereby incurred unnecessary penalty costs.

--charged penalties against mortgagors' tax escrow accounts even though late payments were HUD's fault.

--lost property sold at a local sheriff's sale because taxes were not paid, and

--sold property but was unable to obtain a clear title because speculators had purchased delinquent HUD property tax bills.

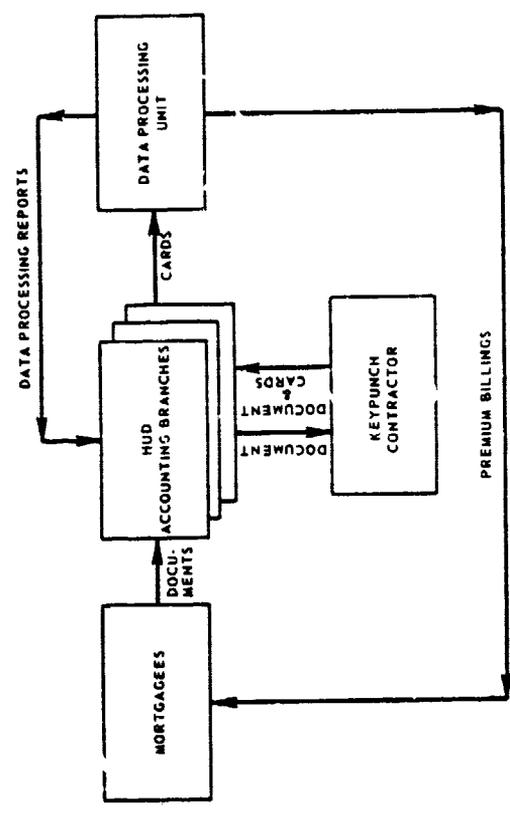
We are currently reviewing HUD's accounting system for paying taxes on multi-family and assigned single family properties in order to determine the extent and causes of these problems.

Madam Chairwoman, this completes my prepared statement. Attached to my statement are flow charts of HUD's automated system for billing and collecting mortgage insurance premiums and schedules of examples showing the results of our review of the pilot program for paying property taxes, which we suggest be made part of the record. The schedules and examples are also included in the visual aids which will be used in a presentation to be given by John Cronin of my staff and Daniel McCafferty of our Cincinnati Office. If agreeable

with you, Madam Chairwoman, I would now like to have these gentlemen make their presentations.

After the presentation we will be glad to answer any questions you or other members may have.

BILLING AND COLLECTION SYSTEM
FOR MORTGAGE INSURANCE PREMIUMS
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT



MONTHLY BILLING PROCESS
DEPARTMENT OF HOUSING & URBAN DEVELOPMENT

